SUPREME COURT, U. S.

Supreme Court of

October Term, 1962

THE NEW HAVEN INCLUSION CASES

ON APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK AND ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF OF APPELLANT THE CHASE MANHATTAN BANK

APPELLANT-PETITIONER

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IN THE

Supreme Court of the United States

October Term, 1969

THE NEW HAVEN INCLUSION CASES

ON APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK AND ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT BEFORE JUDGMENT

REPLY BRIEF ON BEHALF OF THE CHASE MANHATTAN BANK, N.A., AS TRUSTEE, APPELLANT-PETITIONER-RESPONDENT

This brief is in reply to the briefs of Government counsel and Penn Central Transportation Company (Penn Central) which support the decree of the majority of the three-Judge Court. Reference will also be made herein to the briefs of the States of New York and Connecticut.

1. **The Commission's injection of new "factors" to hold down the price payable by Penn Central.** As was to be expected, the Government brief in this Court parallels that of Penn Central. Therefore, a reply to either brief is also a reply to the other.

Ever since the informal secret agreement for the purchase by Penn Central of the New Haven was publicly announced in April 1965 (it was later superseded by a formal agreement dated April 21, 1966),* the Commission

* The agreement was expressly subject to the approval of the Commission and the Reorganization Court as well as to the consummation of the Penn Central merger.

has been trying to hold down the price payable by Penn Central to, or near to, that so agreed to by Penn Central.

In the Second Supplemental Report dated November 16, 1967 (which is the first Commission report relating to the terms of New Haven inclusion), the Commission went through a process of adding some items and subtracting others, but the almost miraculous end result was that the $125,000,000 asset value it approved was the price that Penn Central had agreed to pay.

When both Courts below thereafter found such price to be inadequate by some $33,000,000 to $55,000,000 (the range of probable error stated by the three-Judge Court being $45,000,000 to $50,000,000), they remanded the proceeding to the Commission for revision in accordance with the liquidation value standard. The Commission was at the same time directed also to state and support by findings any other pricing theory which the Commission would want to adopt in lieu of the liquidation value standard approved by the Court. The purpose of that suggestion was that this Court should have both such standards before it when the matter came to this Court for review.

Thereafter, the Commission's Fourth Supplemental Report dated November 25, 1968 (its second report as to the terms of inclusion) made it clear that it had no alternative pricing theory to present. Pursuant to the Courts' directions, it proceeded in that Report to find an increased "net liquidation value" of $162,700,000 which replaced its former $125,000,000 valuation. However, in the Commission's view, this increased price resulting from the application of the remand directions was too far above what Penn Central had initially agreed to pay. The Commission therefore adopted two new discounts aggregating $22,100,000 (the Government brief (p. 52) refers to them as "refinements") which had been suggested by Penn Cen-

tral counsel in the hearings on remand and which the Commission used to reduce "net liquidation value" from $162,700,000 to $140,600,000. The Penn Central and Government briefs now admit that the liquidation value standard is applicable in this case. Accordingly, their two new discounts (called by the Commission "Other Pricing Considerations" (334 I.C.C. at p. 53, App. 140a)) are merely newly adopted deductions from the result of revising the liquidation value in accordance with the Court directions on remand.

The Commission seems to us to be completely unsuccessful in its attempted explanation of why application of the liquidation value standard required deduction of such two discounts in its 1968 valuation but not in its 1967 valuation. The Government brief states (*e.g.*, p. 12) that when it found that the $125,000,000 price was at least as high as liquidation value, it did not have to consider whether liquidation value was "in fact less than that amount".* The brief goes on to say (p. 18) that when the prior valuation figure was increased by a substantial amount on the revaluation ordered by the Courts this required the Commission "to analyze factors that had not previously been relevant".** In this connection, the brief quotes from

* It is a strange concept which envisions a Commission valuation as having been arrived at without considering whether the valuation should "in fact" be lower or higher. The bondholders had claimed a liquidation value far larger than $125,000,000, which claim the Commission rejected; and such rejection would be without any basis unless the Commission had considered whether the liquidation value should be more than $125,000,000.

** The Penn Central brief (p. 10) makes the extraordinary argument in support of the two discounts that the Commission upon the remand for the first time had to "actually appraise the realistic liquidation value of the New Haven". Are they saying that the Commission prior thereto was not trying to arrive at an "actual" and "realistic" valuation? That is hardly a persuasive rationalization of the adoption of those discounts.

the Commission's opinion which admits in so many words (334 I.C.C. at p. 53, App. 140a) that the revised net liquidation value of $162,700,000 "is the valuation we used in the inclusion report to appraise the fairness of the purchase agreement price then available for use". Yet the Commission refused to let that revised valuation stand without injection of the two new discounts.*

This reasoning is not understandable. How is it possible for the Commission to determine that the agreed price is at least as high as liquidation value if there is no definitive determination as to what liquidation value is? The Commission seems to be saying that its original $125,000,000 valuation was final so far as the New Haven creditors were concerned (subject to Court review) but was not final and was somehow tentative and subject to reduction by the Commission so far as Penn Central was concerned. However, the Commission was unequivocal in its finding concerning that original valuaton; it said flatly (331 I.C.C. at p. 688, App. 46a):

> "Based on our own judgment after analyzing and interpreting the entire record, we find that the liquidation value of the NH assets to be conveyed to Penn-Central is about $125 million as of December 31, 1966."

There is nothing in that finding which indicates that the Commission had not made all the deductions which should have been made in order to arrive at such valuation. We submit that it is impossible for the Commission now to sustain in this Court the proposition that the fact that increased valuations were ordered by the Courts below

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* The Government brief (p. 30) states that in the remand proceeding the Commission found a "net liquidation value" of $140,600,000. But the initial finding in that Report (334 I.C.C. at p. 53, App. 140a) specifically is that "The net liquidation value of the NH estate is $162.7 million".

entitled it to offset such increases by new "factors" dredged up by it for that purpose.

We think, along with the Reorganization Court and the dissenting Judge in the three-Judge Court, that these two new "factors" were injected into these proceedings for the specific purpose of holding down unjustifiably the price which Penn Central is required to pay.

2. **The delay discount of $15,386,000.** The Government brief (p. 43) purports to describe and discuss a portion of the first opinion of the three-Judge Court relating to "the cost of seeking an abandonment certificate". But the description of that portion of the Court's opinion seems to us to be far from a correct statement as to what was said and done by the Court. What the Court there did (289 F. Supp. at pp. 438-9, App. 354a-355a) was to reject Penn Central's contention seeking a reduction for the cost of such a delay.

The Court referred to the bondholders' claim that but for the prospect of inclusion, abandonment proceedings would have begun at the beginning of 1964 which would make December 31, 1966 an entirely reasonable date for the beginning of the assumed liquidation. The Court gave its approval to that contention, pointing out that a considerable portion of the New Haven losses would be borne by the New Haven estate following December 31, 1966 and that postponement of the December 31, 1966 date for the beginning of such liquidation with assessment of an alleged cost of such delay on the New Haven estate would produce a double deduction from the estate for which "there would be no justification".

Clearly, this discussion in the three-Judge Court's opinion supports the objections which the bondholders make

to the large "delay" discount and the Government brief fails in its effort to negate the significance of that portion of the opinion.

The Penn Central brief (*e.g.*, p. 26) seeks to emphasize the fact that the Reorganization Court in its first review opinion (289 F. Supp. at p. 459, App. 245a) envisaged the obtaining of an abandonment certificate before liquidation commenced. In its second opinion the Reorganization Court explained that reference, saying (304 F. Supp. at p. 797, App. 305a) that, if a certificate were needed, "it was not contemplated by this court that abandonment proceedings would take more than four to six weeks. The New Haven had been studied, examined and reported on almost continuously since 1957. For the seven and a half years of the reorganization the states, municipalities and the federal government had been heard over and over again. Nothing more than pro forma abandonment proceedings were called for".

In the same second opinion (304 F. Supp. at p. 801, App. 285a) the Reorganization Court, after referring to the large losses of the New Haven over a period of seven and one-half years, said that it adhered "to the position that due process and just compensation provisions of the Fifth Amendment prohibit the imposition of a further period of erosion of assets on the New Haven".

The briefs of the Government and Penn Central argue that there was some kind of waiver or estoppel nullifying the constitutional rights of the New Haven bondholders to apply for liquidation because it was not until May 1967 that bondholders applied for dismissal of the Section 77 proceeding. Both Courts below have rejected that contention. Those rights of the bondholders existed irrespective of any such application and would be just as strong today if that application had not been made. This is not a situation

involving an election of remedies. Constitutional rights are not so fragile that they are lost as easily as the Government contends. These rights of the bondholders are to be determined now, irrespective of whether there was an earlier effort to assert them. Such matters remain open for judicial determination under the decision of this Court in *Penn-Central Merger Cases*, 389 U. S. 486 (1968), pp. 507-511.

3. **The bulk sale discount of $6,695,000.** The Government brief (pp. 52-9) seeks to support the bulk sale discount concept in a way wholly different from its basis as stated by the Commission in its Fourth Supplemental Report. For example, whereas the heading of this discussion in the Commission's Report is "Limitation on the right to break up the railroad" (334 I.C.C. at p. 60, App. 147a), the heading in the brief (p. 52) is "The bulk sale discount is an appropriate minimum reflection of risks which were not taken into account in the land appraisals and the prior discounts".

Similarly, the Commission's Report sought to answer the criticism of its discount in respect of a bulk sale to a wholesaler like Mr. Simon for sales at retail with the following statement (334 I.C.C. at p. 61, App. 148a):

> "Our answer is that we may compel the bulk sale and the bulk sale discount as a condition of an abandonment certificate, and, therefore, as a reduction of the present price".

But now this rationale relating to a bulk sale to a wholesaler has completely disappeared from the Government brief; all that is mentioned is that the bulk sale discount is a "measure of risks" (*e.g.*, p. 54). The very nomenclature gives away the fact that this was not the genesis or intent of this new discount; the deduction would hardly

have been called a "bulk sale" discount if the basis now presented in an attempt to support it really were its original purpose.

Divesting the discount from its "bulk sale" appellation, leaves it a bald effort to justify a further arbitrary reduction in value and in price. Of course, any valuation has some uncertainty but, when a fair market value appraisal is made, the possibility of a decrease in value is matched by the possibility of increase. In the present case, it cannot be said that the Commission overlooked such prospects in its original valuation* so that an arbitrary new "risk" discount should be added to the large discounts to present worth and the slashes in market value already made along with deduction of all the expenses of a six-year sale program.

In this connection, the Government brief (p. 52) refers to testimony that a liquidation of the New Haven would have an adverse effect on real estate market values generally. That is not a new risk. The Commission stated in its initial Report (331 I.C.C. at p. 667, App. 25a) that the Penn Central and New Haven real estate appraisals gave no consideration to the impact of termination of New Haven operations on the real estate market. In the light of this state of the record, the Commission went on to find

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* The Fourth Supplemental Report refers (334 I.C.C. at p. 62, App. 149a) to the fact that the Second Supplemental Report rejected Penn Central's contention that the discount to present worth should be at the rate of 7% rather than 6% and states as a reason for such rejection that the land appraisals were conservative. As to this, the Commission in the Fourth Supplemental Report also says (334 I.C.C. at p. 62, App. 149a) that it "rejected the greater discount in the inclusion report only since we thought that the risk of making the parcel-by-parcel sales was adequately reflected in the appraisals and the 6 percent discount". Nevertheless, the Commission in the Fourth Supplemental Report proceeded to increase that discount from 6% to 10.5% on the ground that the increase was needed "to attract a bulk sale buyer" for the land (334 I.C.C. at p. 62, App. 149a).

(331 I.C.C. at p. 667, App. 25a) that "The record supports the NH trustees' estimate of land valuation"; and the Commission further referred (331 I.C.C. at p. 664, App. 22a) to the valuation of the New Haven assets as being on the conservative side.

The effort to salvage the bulk sale discount, which all the Judges found meritless as such, by converting it into a "risk" discount in the same amount to be piled on top of all the reserves and discounts already deducted is arbitrary and without merit.

4. The net income ($5,600,000 annually) derived from the Grand Central Terminal hotel and office buildings formerly used to defray the New Haven's user share of Terminal expenses. The Penn Central brief (p. 98 *et seq.*) endeavors to make it appear that the Courts below have unanimously viewed as without substance the New Haven's claim in respect of the $5,600,000 of annual non-railroad net income transferred without compensation by the New Haven to Penn Central.

We therefore point out that the Reorganization Court, while ruling against this New Haven claim, nevertheless indicated that the claim was one of substance. After referring to the large difference in the total valuations of the two Courts below, the Reorganization Court continued (July 28, 1969 opinion, 304 F. Supp. at p. 1124, App. 314a-315a) as follows:

> "This price difference alone makes appeals and cross-appeals from both courts inevitable. If this conclusion needs buttressing, it is supported by at least three additional factors: . . .
>
> "(2) The ultimate value of New Haven's interest in the Grand Central Terminal properties might far exceed that which this court has found. Take, for example, only one item, although a major one, and that

is the value of New Haven's right of access to the Grand Central Terminal, which the I.C.C. found to be of no value—a determination which this court finally concluded in its Memorandum of May 28, 1969, could not be disturbed, although in its opinion of August 13, 1968 (289 F. Supp. 451, at 463), it was of the view that on remand the I.C.C. should reconsider on the basis that the New Haven's right was valuable. If on appeal the existence of such a right were to be recognized, the evidence presently in the record would show a potential worth of approximately $70 million. . . ."

The Penn Central brief (pp. 102-3) states that our "notion" that the basic Terminal agreement of 1907 was wiped out by its transfer to Penn Central (which thereby became the only party to the agreement) was inconsistent with the New Haven's claiming to have any remaining rights in the Grand Central properties, *i.e.*, that the New Haven's rights would be wiped out too.

In the first place, it would seem to be unquestionable that, when one of two parties to an agreement assigns the agreement to the other party, the agreement, and its restrictions and obligations, are *ipso facto* terminated because the transferee cannot have obligations to himself.

Turning to the alleged inconsistency, that is based on the notion of Penn Central counsel that the New Haven's rights depend on the continued existence of the basic agreement. That is an erroneous premise.

From the basic agreement of 1907, as supplemented in 1913, there grew a joint real estate venture whereby Central and the New Haven shared equally in financing the construction of numerous and extremely valuable Grand Central Terminal hotel and office buildings having an ap-

praised (and undisputed) value of $227,000,000 and an annual net income of over $13,000,000. The New York Appellate Division decision in the so-called *Biltmore* case* sets forth the history of the relationship of the two railroads with respect to these non-railroad properties and concludes that a partnership was created with respect to such properties. Thus, the Appellate Division opinion states (13 A.D.2d at p. 318) that the Central and the New Haven had "converted themselves into owners of the fee together, as far as the area of this controversy stretches" and (pp. 319-20) that the description of the New Haven's position would be that of a partner.** Termination of a partnership (as for example by death of a partner) certainly does not forfeit the ex-partner's interest in the partnership property to the surviving partner. Accordingly, while the joint real estate venture of the two railroad partners grew out of the 1907 basic agreement as supplemented in 1913, the venture when developed was separate from the basic agreement

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* *New York Cent. R.R. Co.* v. *New York, New Haven & Hartford R.R. Co.*, 24 Misc. 2d 414 (Sup. Ct. N. Y. County, (1960), *modified* (in a respect not relevant here), 13 A.D.2d 309 (1st Dept., 1961), *aff'd without opinion*, 11 N.Y.2d 1077 (1961).

** The Government brief seems to be content with the description of the New Haven interest as that of a partner since it cites (pp. 70-1) an opinion of the New Haven's former counsel which, wobbling back and forth, questions the assignability of the New Haven's interest on the ground that it is a partnership interest which may not be assignable.

In the Government's quotation from that opinion, there is included a reference to a clause of the basic agreement barring an assignment by a party to a competitor of the other party. That clause, being in addition to the ordinary anti-assignment clause discussed in our main brief (p. 76 et seq.), evidences the doubt of the parties as to the efficacy of the ordinary anti-assignment clause; otherwise the additional clause would have been entirely unnecessary.

The clause which bars assignment to a competitor has no application in the present case as a practical matter. The only entities which, in addition to Penn Central, have been mentioned as possible assignees are the States and they were not competitors of Penn Central.

except that the joint venture net income was applied, to the extent needed, to defray each railroad's respective share of Terminal expenses on a user basis.

The right of the New Haven to its share of the net income from these hotel and office buildings in excess of the amount of Terminal expenses has been adjudicated and is no longer open to question. This conclusively demonstrates that the New Haven's interest in the net income of the real estate joint venture was not forfeited when the basic agreement terminated. Upon the termination of the basic agreement and the simultaneous cessation of use of the Terminal by the New Haven, the New Haven was no longer subject to any rental obligation and it was then just as much entitled to the balance of its interest in such hotel and office building net income (formerly used to defray its user proportion of Terminal expenses).*

Both the Penn Central brief (p. 102) and the Government brief (p. 67) cite *I.C.C.* v. *New York, N. H. & H. R. Co.*, 287 U. S. 178 (1932), but the case has no relevance. This Court there held that it would not enjoin the Commission from excluding the value of the Grand Central property from its rate-making valuation of the New Haven but further ruled (p. 203) that it was not approving this omission and was holding only that valuation thereof by

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* The Penn Central brief (p. 100) emphasizes that all the net income from the hotel and office buildings was initially paid into the Terminal account pursuant to Section 14 of the basic agreement. That was merely a matter of accounting convenience. The fact that the excess net income was paid into that account has not stood in the way of the unappealed holdings by both Courts below that the New Haven was nevertheless entitled to the value of its share of such excess net income. Similarly, when the New Haven ceased to owe rent because its use of the Terminal ceased, the Terminal account procedure likewise would not stand in the way of the New Haven's receiving the value of its remaining share of the net income.

the Commission could not be enforced by *mandamus*. The lack of relevancy is demonstrated by the fact that, notwithstanding that decision, the *Biltmore* case some 30 years later gave full recognition to the New Haven's partnership interest in those Grand Central non-railroad properties.

We shall refer only briefly to the briefs of New York and Connecticut which are limited to this issue and argue that Penn Central should not be required to pay anything to the New Haven for the $5,600,000 per annum derived from the New Haven interest in the Grand Central non-railroad properties or at least that the payment should not be more than $27,000,000.* This is not an unbiased point of view. It is obvious that the States are not concerned with what is fair and equitable as between the parties to the sale transaction but rather with the negotiations between the States and Penn Central for the States' taking over the commuter business into the Terminal. We submit that the desire of the States to improve their position in such negotiations is not properly a part of the price issues which are before this Court on these appeals.

5. **The freight-only studies.** The Government brief (p. 12) and the Penn Central brief (p. 31) refer to a study by a railroad expert (Mr. William Wyer) which bondholder interests introduced into evidence and in which it was estimated that on a freight-only basis the New Haven might have had net operating income in 1964 and 1965 after modernization and reconstruction of the railroad.

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* At page 4 of New York's brief, it is asserted that the New Haven's 41% share of Grand Central Terminal operating expenses would be about $2,170,000 annually instead of $5,600,000 and that "Capitalized at 8 percent, the $2.17 million would amount to about $27 million, instead of the $70 million figure used by appellants."

The New Haven Trustees also introduced a freight-only study but it only showed deficits.

The Government brief states (p. 12) that "The [Wyer] study was not projected beyond 1965, and for that reason the Commission rejected it as not sufficiently current". The Commission had also found that continuance of passenger service was "essential" (*e.g.*, 327 I.C.C. at pp. 216-8).

Now the Government and Penn Central seem to want to treat that unsuccessful effort as some kind of admission against interest. Perhaps we should counter by referring to Penn Central's position in its initial June 5, 1967 brief to the Commission in which it criticized the Wyer study at length and asserted (p. 103) that "The New Haven has no prospective earnings". That position was sustained.

Accordingly, the state of the record is that an effort was made by bondholder interests to present in the Spring of 1967 a plan for reconstruction of the New Haven on a freight-only basis which might theoretically have produced net operating income for 1964 and 1965, that the effort was successfully opposed by Penn Central as being visionary and impractical and out-of-date and that the Commission rejected the study in November 1967, saying among other things (331 I.C.C. at p. 687, App. 45a):

> "If there is one thing on this record that is clear and undeniable, it is that NH has neither earning power nor the prospect of earning power".

None of the parties has claimed in this Court that the rejection was erroneous. The freight-only concept is, therefore, out of the case.

6. **The recent reduction of the New Haven's real estate tax liability to the City of Boston.** The attempt in the

Government brief (pp. 17-18) and in the Penn Central brief (p. 117) to capitalize on the recent compromise of the real estate taxes owed by the New Haven to the City of Boston is disingenuous as can briefly be demonstrated.

The Commission, in calculating the price which Penn Central should pay for the New Haven assets, had deducted $16,200,000 of unpaid real estate taxes owed to Boston among others. This deduction was made notwithstanding that the New Haven was obligated by the purchase agreement to convey the New Haven real estate to Penn Central free and clear of tax and other liens. If this deduction from the price had been allowed to stand, the New Haven would have been charged twice with the $16,200,000 of taxes—once when they were deducted from the price and a second time when they were actually paid by the New Haven.

Accordingly, this $16,200,000 deduction was restored to the price and the New Haven thereupon remained obligated to pay the real estate taxes whether they turned out to amount to $16,200,000 or to more or less than that amount.

Clearly, what the New Haven would thereafter have to pay to the taxing authorities in respect of such taxes simply had, and has, no bearing on the price Penn Central should pay to the New Haven. Those taxes are solely a liabilty of the present New Haven estate and are therefore of no concern to Penn Central which acquired the property free and clear of all tax liens. Therefore, the recent $3,200,000 reduction in the New Haven's real estate tax liability to the City of Boston cannot properly be used in support of the Penn Central position on these appeals.

7. **The payment to be made to the B&P stockholders.** There is no justification for the assertion in the Govern-

ment brief (p. 22) that the Commission was more than fair to the New Haven in transferring from the New Haven to Penn Central the obligation to pay $2,300,000 to the public stockholders of the Boston & Providence Railroad in order to acquire their stock.

The Commission had valued the B&P assets at $11,200,000, less $3,100,000 of liquidation expenses (334 I.C.C. at p. 50, App. 137a), which is a net valuation of $8,100,000. Deducting the New Haven's $2,300,000 obligation to the B&P stockholders from $8,100,000 resulted in Penn Central's being required to pay to the New Haven $5,800,000 for the B&P assets. Penn Central in this way obtained the $2,300,000 credit on the price payable to the New Haven, and Penn Central necessarily had to assume the obligation to pay that $2,300,000 to the B&P stockholders which it had been paid in full to do. On the other hand, if the obligation to make that payment had remained with the New Haven, Penn Central would have had to pay the New Haven $8,100,000 instead of $5,800,000 for the B&P. The Government's claim is wholly without substance.

CONCLUSION

We respectfully ask for the relief sought in our main brief dated February 26, 1970.

Respectfully submitted,

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